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Trehane, John

The United States Steel Corporation

[London]

[4th June, 1902]

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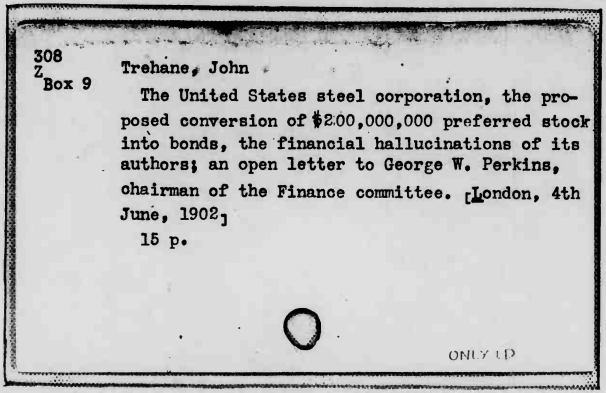

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Trehane, John

The United States steel corporation, the proposed conversion of $200,000,000 preferred stock into bonds, the financial hallucinations of its authors; an open letter to George W. Perkins, chairman of the Finance committee. [London, 4th June, 1902]

15 p.

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THE UNITED STATES STEEL CORPORATION.

THE PROPOSED CONVERSION

OF

$200,000,000

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Preferred Stock, into Bonds.

The Financial Hallucinations of its Authors.

An Open Letter to GEORGE W. PERKINS,

Chairman of the Finance Committee.

8 Sept 1915 292

The United States Steel Corporation

AND THE

Preferred Stock Conversion Scheme.

LONDON, 4*th June*, 1902.

To GEORGE W. PERKINS, ESQ.,

Chairman of the Finance Committee of the United States Steel Corporation.

DEAR SIR,

I have seen reported in several New York papers, which gave an account of the proceedings at the Stockholders' Meeting on the 19th ult., some remarks which you made to the Stockholders at the close of the meeting. These appear to constitute the only defence of the Conversion Scheme which was attempted, and they are entitled to careful and respectful consideration, coming as they do from the ingenious author and originator of the Scheme.

The papers all agree as to the purport of your remarks; but I will take the report as it appears in the New York *Sun* of the 20th ult., because it is evidently an organ friendly to you, and it gives the very words you used.

The report reads as follows :—

"The meeting adjourned in good humour, the dissenting Stockholders expressing their thanks for the full hearing they had had. After the adjournment Mr. Perkins made a speech and invited the Stockholders to take notes, so that they might have some figures to compare. He said:

'I know that there has been some feeling here to-day, but I believe that the opposition sprung from worthy motives, and that the opponents thought they were acting in the best interests of the United States Steel Corporation.

'When the Company was put together we had money enough to cover every expense except one, which was an unknown quantity — the expenditure for which the subsidiary companies had already arranged. We found afterward that these contemplated expenses amounted to $40,000,000 or $50,000,000. They were reduced to about $15,000,000. To capitalize that and to round out the general plan and harmonize the different parts about $50,000,000 is needed.

'We might have got it by issuing more Preferred Stock. We couldn't have got more than 90 for it, or $45,000,000 for $50,000,000 face value. There would have been an initial cost of $5,000,000, but the expense of raising our $50,000,000 wouldn't have stopped there, because we would have had so much more stock to pay 7 per cent. dividends on or an additional expense each year of $3,500,000.

'We might have issued a second Mortgage Bond, but couldn't have got more than 95 for it. There would have been an initial cost of $2,500,000 and an interest cost of $2,500,000 every year.

'But by the Scheme we have finally adopted we have an initial cost of $10,000,000, but the expenses stop right there. For the rest, we save the difference between our 7 per cent. dividends and the 5 per cent. interest on the Bonds.

'We have been criticised for being over-capitalized. It is rather a pleasant thing, then, to retire some of the stock.'"

If you will permit me to say so with deference, you evidence a mental confusion as to the difference between an interest payment and a dividend on stock, and also as to the difference between a Corporation as a commercial entity and the Stockholders who are partners in the Corporation, which one would hardly have looked for in a financier of your training and experience. Let us try and make some definitions as accurately as possible.

What is the difference between an interest payment on a mortgage, and a dividend on stock?

An interest payment is something which the Corporation is obliged to pay out of its assets, not only when it is making profits, but when it is working at a loss; it must pay it all, whether times are good or bad, and cannot save a dollar out of it; it is a charge on the assets; it is an expense which must be incurred.

A dividend on stock is quite a different thing. It is not payable out of the assets of the Corporation, nor is it a charge on them; it is not a necessary "expense," to use your own word. If no profits are earned, no dividend is payable; if profits are earned, the Corporation,—by its Directors,—first looks after its own interests, and provides out of them its necessary reserves; then, if there is anything left for which it has no use, it distributes it in dividends to the partners in the concern—the Stockholders. The rate of dividend they receive does not matter in the least to the Corporation, whether it be 5 or 7 or 20 per cent., because if it had in any way needed the money, the Corporation could *have kept it all* and paid no dividend.

Having made this definition, let us see how far your statements quoted above are accurate.

You compare two schemes of raising the $50,000,000 needed: the one, that of issuing $50,000,000 additional 7 per cent. Preferred Stock, the other, your own ingenious

scheme of raising $50,000,000 by issuing $250,000,000 5 per cent. Bonds.

As to the first scheme you say :—

"We might have got it by issuing more Preferred Stock. We couldn't have got more than 90 for it, or $45,000,000 for $50,000,000 face value. There would have been an initial cost of $5,000,000, but the expense of raising our $50,000,000 wouldn't have stopped there, because we would have had so much more stock to pay 7 per cent. dividends on, or an additional expense each year of $3,500,000."

This is not an accurate statement of the case. It is true that the Preferred Stock being issued at 90 the Corporation would only get $45,000,000, but the $5,000,000 difference would not be a "cost" or "expense" to the Corporation as you put it, any more than the 7 per cent. dividend would be. The Corporation would not pay away a cent from its treasury, and it would get $45,000,000, simply by giving the people who provided the money a right to have a dividend of 7 per cent., on $50,000,000, if the Corporation, by good luck, should earn profits enough to satisfy all its own needs, and afterwards pay a dividend out of the residue.

Now let us deal with your description of your own Scheme. You say :

"But by the Scheme we have finally adopted we have an initial "cost of $10,000,000, but the expenses stop right there. For the "rest we save the difference between our 7 per cent. dividends and "the 5 per cent. interest on the Bonds."

This is indeed an extraordinary statement. It is true that you start by paying away $10,000,000 out of your treasury, instead of nothing at all as in the other case. But "the expenses stop right there!" Do they indeed? What about that little item of $13,510,000 which you will have to find year after year, in good times and bad, and which you will have to take out of working capital, or borrow at heavy

interest if you make no profits? What is to be the offset to this enormous fixed charge? Here it is: You say "we shall save the difference between our 7 per cent. dividends and the 5 per cent. interest on the Bonds." But as we have seen in our definition, if the Corporation is at all in want of money, *it can save the whole of the 7 per cent.*, amounting to $14,000,000, which is only payable out of profits after its own needs are satisfied. And yet you run it into debt annually to the tune of $13,510,000, in order that it may "save," as you call it, the poor little sum of $490,000 instead!

Now let us go into figures, and see exactly the results of the three schemes, either of which you say could have been adopted if the Board had chosen. We will begin with your own pet, the Scheme actually adopted.

SCHEME No. 1. THE PERKINS SCHEME.

Amount in cash realised by the Corporation, Par value of Bonds	$50,000,000	
Less commission out of current earnings	$10,000,000	
		$40,000,000

Cost to the Corporation :—

Decrease in power of Corporation to borrow money, in order to acquire new properties or tide over periods of depression and danger	$250,000,000
Annual fixed charge for interest and sinking fund	$13,510,000

SCHEME No. 2. THE $50,000,000 BOND ISSUE.

Amount in cash realised by Corporation at 95 (your own figure)	$47,500,000

Cost to the Corporation :—

Decrease in power of Corporation to borrow money, in order to acquire new properties or tide over periods of depression and danger	$50,000,000
Annual fixed charge for interest and sinking fund	$2,700,000

SCHEME No. 3. THE $50,000,000 PREFERRED STOCK SCHEME.

Amount in cash realised by Corporation by issue at 90 (your own figure)	$45,000,000
Decrease in power of Corporation to borrow money, in order to acquire new properties or tide over periods of depression and danger	None.
Annual fixed charge for interest and sinking fund	None.

Let us see how much would have been saved to the Corporation if you had carried out Scheme No. 2 instead of your own bantling.

Saving by Scheme No. 2 as against the Perkins Scheme :—

Scheme No. 2—Amount in cash realised by Corporation	$47,500,000
Perkins Scheme „ „ „	40,000,000
Saving by No. 2 ...	$7,500,000
Perkins Scheme—Decrease in power to borrow	$250,000,000
Scheme No. 2— „ „ „	50,000,000
Saving by No. 2 ...	$200,000,000
Perkins Scheme—New fixed charge ...	$13,510,000
Scheme No. 2— „ „ „ ...	2,700,000
Saving by No. 2 ...	$10,810,000

Now let us see what would have been the saving to the Corporation if Scheme No. 3 had been adopted instead of your own project.

Saving on Scheme No. 3 as against the Perkins Scheme :—

Scheme No. 3—Amount realised by Corporation by issue of $50,000,000 Preferred Stock at 90 (your own figure)	$45,000,000
Perkins Scheme—Amount realised in Cash	40,000,000
Saving by No. 3 ...	$5,000,000
Perkins Scheme—Decrease in power of Corporation to borrow	$250,000,000
Scheme No. 3	None.
Saving by No. 3 ...	$250,000,000
Perkins Scheme—New fixed charges ...	$13,510,000
Scheme No. 3— „ „ „ ...	None.
Saving by No. 3 ...	$13,510,000

The above are your figures, and not mine. *You* say, that either of the three Schemes could have been carried out at the figures named.

BY FORCING YOUR OWN SCHEME ON THE CORPORATION, INSTEAD OF ADOPTING SCHEME NO. 3, AND ISSUING $50,000,000 NEW PREFERRED STOCK, YOU HAVE INVOLVED IT IN THE FOLLOWING LOSSES :—

Cash realised, less	**$5,000,000**
Decrease in borrowing power	**$250,000,000**
Annual fixed charges	**$13,510,000**

You concluded your little speech with the following complacent reflection: "We have been criticised for being over-capitalized. It is rather a pleasant thing, then, to retire some of the Stock." Do you not think that the criticisms of those who thought your capital too large would have been ten times stronger if they had seen $200,000,000 in 5 per cent. Bonds, instead of in Preferred Stock?

For whom is this little operation of yours a "pleasant thing"? Certainly not for the Corporation. Whether its Preferred capital is $500,000,000 or only $300,000,000 is of no consequence to it, because the amount, whatever it may be, only takes its annual surplus profits, for which it has no use, and its assets on dissolution. But it is a very different thing when, instead of "retiring" $200,000,000 as you put it, you convert that amount into a mortgage debt, and burden the Corporation's assets with a new annual fixed charge of $13,510,000.

Is it a "pleasant thing" for the Preferred Stockholders, when you make their stock junior to this new mortgage and fixed charge, and their dividend is still to remain at 7 per cent?

Is it a "pleasant thing" for the holders of the Common Stock? Certainly not for those of this generation, who will only see the power of the Corporation to earn dividends crippled by the reduction of its borrowing powers by $200,000,000. But, if the way of the Corporation shall in the future be along the primrose path of an unvarying success, then your grandchildren, who we will hope will be numerous and happy, may, while drawing increased dividends on their Common Stock, bless the ingenious and novel device of their honoured grandsire.

But to be just, this will not exhaust the list of those who will appreciate your scheme as a "pleasant thing," because in this generation there still remain the members of the firm of

J. P. Morgan & Co., and "some of the Directors," too modest to disclose their names, who are in the underwriting Syndicate. They will divide between them the sum of $10,000,000 for providing the Corporation with the sum of $50,000,000; and a commission of 20 per cent. in a transaction, which you are careful to explain could be carried out for a commission of 5 per cent., certainly does merit the epithet you apply to it. It must be pleasant—very pleasant—for the Syndicate!

Perhaps I do you an injustice, and no doubt you will have an opportunity of giving elsewhere a complete account of the transaction, which may change its present aspect. But it really does look as if, when you and the other Directors who are members of the Syndicate, sat at the Council Board, and as Trustees for the Corporation and its Stockholders commenced to bargain with yourselves as individuals, the temptations, to which poor frail human nature is always subject, were too much for you. It does seem that the interests of your beneficiaries were not quite as well served as they would have been, if the Board had been composed exclusively of such men as Mr. Percival Roberts and Mr. W. E. Dodge who, as I learn from to-day's cables, have resigned their seats on the Board rather than proceed any further with the Perkins Plan.

Allow me one word as to the way in which you and your co-directors have treated the European Stockholders in this matter.

Our Corporation is, so far as I know, the largest in the world, and it has a large body of Stockholders, resident not only in the United States, but also in Europe, and, indeed, throughout the world.

Your Stock Register must have shown you this; and, indeed—as to the Stockholders resident in Europe—you and

the "Morgan Syndicate" had a very special knowledge, because you have, during the past year, been good enough to spare from your own holdings the greater part of the Stock now held here.

This Conversion Scheme had given rise to a good deal of consideration, and indeed of controversy, amongst your Directors, and a special bill had been engineered through the New Jersey Legislature to enable you to carry it out.

There was therefore every reason, as there was available ample time, for giving to your Preferred Stockholders the opportunity of carefully considering so momentous a change in their status; it was your duty to give your beneficiaries this opportunity; let us see how you fulfilled it.

You as a Board agreed to the scheme on the 1st April, and your circulars to the Stockholders could well have gone out on the following day. But they were held back until the 17th of April, and did not reach London until the 25th of April, and the Continent still later. While you enclosed a form of proxy for those who approved the Scheme, it was necessarily left for those who dissented from it to choose and instruct their own agent in America and to send him a proxy, which had to be approved by the officers of the Corporation before the meeting on the 19th inst., and for this not less than 14 days could safely be allowed. Thus, the European Shareholders had practically *a week* within which to enquire into and consider the merits of your novel and far-reaching plan.

More than this, you failed to send us the Contract which was the basis of the Scheme, and as to which you only made some vague references. This Contract was an integral part of the Resolutions which you asked us to approve, and in its absence they were not intelligible.

In effect you asked us to approve, and through you to sign, a Contract which we had never seen, and in which you

and your partners in the firm of J. P. Morgan and Co., as well as "some of the Directors," whose names you do not disclose, have an interest adverse to the Corporation. The knowledge of that interest should have made you specially anxious to give full information to the Stockholders.

Forgive me if I ask you a pertinent question. You are all rich men, some of you very rich men; would you be so to-day if you had made it your business practice to sign contracts which you had never read? Some of you, I am told, are lawyers—eminent lawyers; did you ever advise a client to sign a document before perusing it?

By adopting this contemptuous and oppressive attitude towards your Stockholders here, you have aroused a feeling of indignation which you will find it difficult to allay.

It would appear from your speech to the Stockholders that you and your co-Directors have laboured under a curious but honest misconception as to the effect which your scheme would have upon the interests of the Corporation. You have, as I said at the outset, failed to appreciate the difference between a dividend payment, all of which the Corporation can keep if it has any need for it, and an interest payment, not one dollar of which can it save for itself, however dire may be its needs.

I have endeavoured in the definitions and the figures which I have set out above to show you where your error lies, and how very serious is the injury which your scheme, if persisted in, will do to the Corporation.

May I suggest that this is a question into which you should carefully look, and upon which you would do well to consult with a few men outside the Corporation, who have

a special knowledge both of law and of financial principles, such men, for instance, as Ex-President Grover Cleveland and Senator Depew, both of whom, I take it, are your well-wishers.

I feel sure that, not only in the opinion of such specialists as these, but in that of the financial community generally, you would find it to be held that you are wrong in your views, and that a scheme which involves a commission of 20 per cent., instead of 5 per cent., and which unnecessarily fastens on the Corporation a new mortgage debt of $200,000,000, with an annual charge of $10,800,000, is not advantageous to the customer, with whom the House of J. P. Morgan and Co. has made a bargain, while its partners were acting for both parties.

If it should thus be established,—whether your action was upheld in the Courts of Law or not,—that a scheme, which you intended to be beneficial, is in reality injurious, it is certain that as you could not in honour and good morals proceed with it, you would insist on abandoning it. The position which is held by your House in the commercial world is so assured, that you could, not only without loss of dignity, but with an access of public respect, do this, and substitute for your present scheme, either of the two others which you have declared to be practicable. There would be no difficulty in doing this, because the control of the Stock which you and your associates have in your own hands would enable you to undo, or at least to abstain from completing, what you have commenced to do.

I would suggest that you should adopt as the substitute the Scheme (No. 2) for issuing $50,000,000 Mortgage Bonds. If a commission of 5 per cent. is, as you think, necessary, by all means take it, and I am sure that the general public will be glad to pay you par for the Bonds of such an issue, which will be a very different matter from an issue of $250,000,000. In my own small way, I shall be glad to take $5,000 at par.

The result of your doing this will be to remove altogether the distrust, which is now depressing both the Preferred Stock and the Bonds as no combined movement of the "Bears" in Wall Street could depress them.

Yours respectfully,

JOHN TREHANE.

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